Economic Research

بنك أبوظبي التجاري ADCB

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The Week Ahead: ECB to stay on course, China GDP steady

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ECB: to allay tapering fears, no new measures expected

We expect the ECB to strongly emphasise at its monthly meeting (20 October) that tapering of its QE programme in 2017 is not being considered. Market speculation over the last few weeks indicated that the ECB may be looking to reduce its asset purchases early. That said, we still do not expect any decisive new steps to extend or modify the scope of QE in this meeting. The Governing Council (GC) has not yet submitted its recommendations for addressing the issue of sovereign bond scarcity that is adversely impacting the effectiveness of QE. We continue to expect the ECB to extend its asset purchase programme (ending March 2017) by another nine months in its December meeting, by which time the GC's recommendations will be out. In the US, the key data release this week will be September consumer inflation (18 October). CPI is forecast to accelerate to 0.3% m-o-m from 0.2% in August, driven by higher energy prices. This should bring the yearly inflation rate up to 1.5% in September (1.1% previously). Core inflation is expected to remain steady at 2.3% y-o-y.

China: 3Q GDP to remain stable at 6.7% on fiscal support

Growth (due 19 October) is expected to have remained stable in 3Q at 6.7% y-o-y, supported by a looser fiscal and monetary stance. We believe the strong household credit growth in 3Q should result in an acceleration of private consumption and residential investment. This will help to compensate for weaker export growth. Moreover, we envisage investment growth remaining steady, focused on social infrastructure and transportation, bolstered by lending from government-owned development banks. In our view, official comments suggest a shift in the short-term policy stance towards supporting growth, though emphasis on corporate debt sustainability still remains. We expect this will reflect in 2H GDP data. This is especially likely in the run-up to the Communist Party's Congress due in autumn 2017. Meanwhile in the GCC, market interest remains on Saudi Arabia ahead of its first international bond issuance (page 2). There was limited new data in the bond prospectus, though we expect strong demand for the debt. This issuance will be vital for reducing liquidity constrains in the short term.

India: MPC minutes to reveal motivations behind rate cut

The minutes of the first meeting of the RBI's new Monetary Policy Committee (MPC), to be released this week (18 October), will provide more insights into the thinking behind the surprise rate cut on 4 October. In particular, the markets will be curious to know why the RBI lowered the benchmark policy rate by 25 bps, despite raising its inflation forecasts for FY17 and FY18. The minutes should also reveal the MPC's short-term inflation expectations for FY18 and FY19, given its mandate to keep inflation stable in the 2-6% range until FY21. We expect the MPC to keep rates on hold for at least another six months.

I. Recent Events and Data Releases

A. MENA Economies

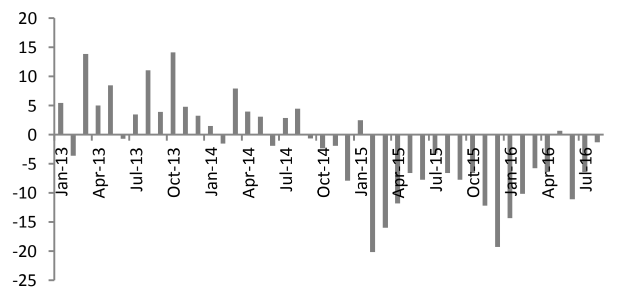
Saudi Arabia: Meeting investors ahead of USD sovereign-bond issuance

Multi-tranche deal expected with possible tenors of five, 10 and 30 years

Saudi Arabia started meeting investors on 12 October in the UK and US ahead of a USD sovereign bond issuance. This will be Saudi Arabia's first international bond issuance, with tenors of five, 10 and 30 years expected, subject to market conditions. The market is expecting KSA to issue at least USD10-15 billion – and potentially more. Demand for the debt is expected to be strong, especially from Asia and the Middle East, despite the recent US JASTA legislation being passed. Low global interest rates have supported demand for GCC debt. Moreover, the recent rise in the oil price to above USD50 p/b with signs of greater OPEC and non-OPEC coordination and further reforms provide investors more confidence on the fiscal front. We have highlighted that the timing of these measures, alongside further liquidity injections by SAMA, were likely partly aimed at supporting investor confidence ahead of the sovereign bond issue (please see **Global Data Watch 3-7 October 2016**). However, we do not expect the pricing to be as favourable as the issues from Abu Dhabi and Qatar earlier in the year given their stronger economic fundamentals.

Fig. 1. Saudi Arabia: SAMA's NFA expected to rise following sovereign bond issuance, as in May

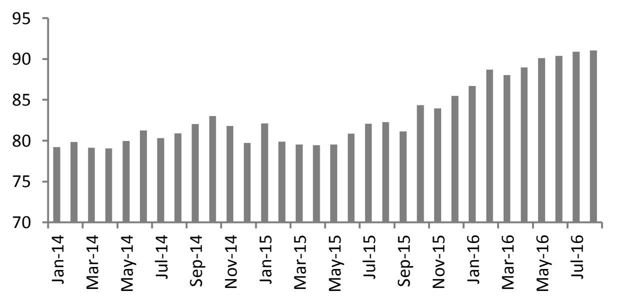
USD billion, monthly change in SAMA's NFAs



Source: SAMA

Fig. 2. Saudi Arabia: Part of funds raised expected to be placed as government deposits in banking sector

L-to-D ratio



Source: SAMA

Domestic liquidity to benefit from international bond

This international bond will be vital in improving Saudi Arabia's short-term liquidity conditions. We expect part of the funds raised to be deposited in the domestic banking system, as was the case with the USD10 billion syndicated loan it raised at end-April. Government deposits in the banking sector rose by USD6.6 billion in May, reflecting this loan. FX reserves are also expected to rise after the issuance. However, with the fiscal position forecast to remain in deficit, we see FX reserves continuing to moderate after the initial boost. SAMA FX reserves have fallen by an average of USD6.8 billion from 2016 per month. The sharply lower USD1.3 billion drop in SAMA's FX reserves in August was surprising, which could imply a marked pull-back in spending. We expect the pace to moderate in 2017 (from the 2016 average) with a marginally higher oil price and further external borrowing. Nevertheless, we expect FX to continue to fall by around USD4-5 billion per month in 2017. We estimate government debt levels to rise to around 17.2% of GDP in 2016, up from 5.9% in 2015.

Saudi reiterates commitment to USD peg

Media indications from the investor roadshows reiterated Saudi Arabia's commitment to its USD pegs. Representatives highlighted that the peg works well for the structure of the Saudi economy. Meanwhile, the bond prospectus provided limited new data, including on fiscal developments. Meanwhile, to support future debt issuances, the Ministry of Finance has established a public debt management office. Its objective is to secure the "financing needs of the Kingdom with the best possible financing costs in the short, medium, and long terms with risks compatible with the kingdom's fiscal policies". The issuance of the sovereign bond will also likely encourage greater corporate debt-raising, with the creation of a benchmark yield curve.

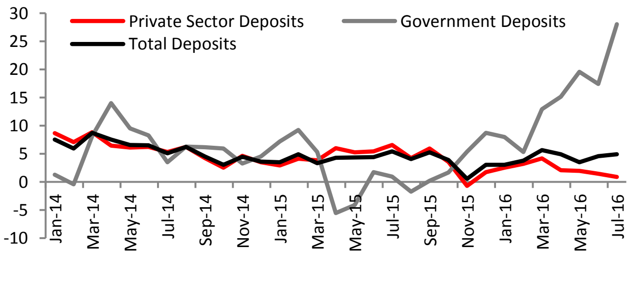
Kuwait: Planned USD10 billion bond postponed to 2017

Rise in government deposits in banking sector to support liquidity

Meanwhile, Kuwait has delayed the issuance of its sovereign bond until 2017, according to Reuters, citing bankers familiar with Kuwaiti debt policy. Markets were expecting Kuwait to issue USD10 billion worth of debt in 4Q. As we have highlighted in our research, Kuwait is in a strong position to fund its fiscal deficit and is not seeing the same liquidity pressure as some other GCC countries. Its loan-to-deposit ratio stood at 84.1% in July 2016, down from 85.6% in December 2015. Government deposits in the banking sector have risen in 2016 (up 28.1% y-o-y in July), which has compensated for weak private sector deposit growth (0.9% y-o-y in July) and a rise in government borrowing. Kuwait has indicated that it is looking to borrow up to KWD2 billion in conventional and Islamic instruments from the domestic market.

Fig. 3. Kuwait: Total banking sector deposits up 4.8% y-o-y in July, with strong rise in government deposits

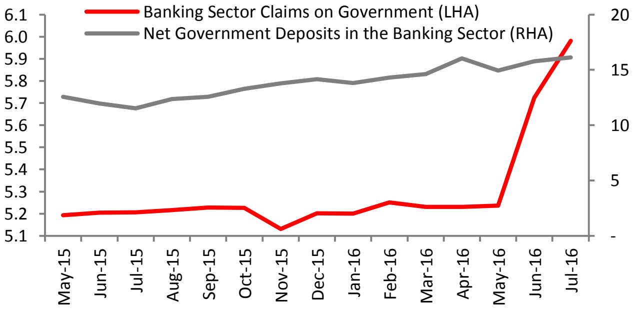
% change y-o-y



Source: Central Bank of Kuwait

Fig. 4. Kuwait: Net government deposits in banking sector rise gradually, despite pick-up in gov. borrowing

USD billion



Source: Central Bank of Kuwait

Parliament dissolved – fresh elections in 60 days

Meanwhile, Emir Sheikh Sabah al Ahmed Al Sabah dissolved parliament on 16 October, with regional security being cited as a factor. Fresh parliamentary elections have to be held within 60 days. The dissolved parliament was scheduled to run through to July 2017. The stability of the last parliament (elected July 2013) and its improved relationship with the government had supported the progress of the investment programme. A potential risk to the investment and growth outlook could be a less co-operative parliament following the next National Assembly elections. A number of opposition MPs who boycotted the previous elections have indicated that they will participate in upcoming polls. Recently, the opposition and MPs have been against the fiscal reforms measures proposed by the government and have moved to tone them down.

Oman: Electricity tariffs for government and large producers increased

Subsidy reform equivalent to around 1% of GDP

Oman will raise electricity prices for large consumers from January 2017, including the government, commercial and industrial sectors. The higher tariff will be applied to approximately 10,000 electricity accounts that consume over 150 megawatts per hour each year. Official estimates suggest that this would impact around 1% of users, which together use 30% of the electricity output and account for 20% of government subsidies for power generation per year. This is the latest round of subsidy reforms targeting industrial users, with gas prices also being raised earlier. The Authority for Electricity Regulation (AER) has indicated that the subsidy reform should amount to around OMR100 million, which we estimate at around 1% of GDP. Despite these reforms, Oman's fiscal adjustment has been relatively weak and we see the need for greater retrenchment of government spending to help bring the deficit down to more sustainable levels.

B. G4 Economies

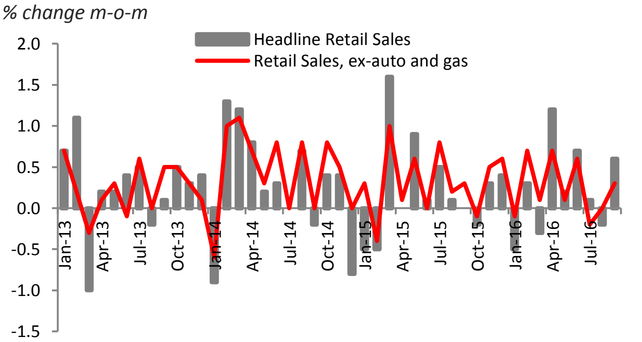
US: Fed moving closer to rate hike; Yellen gives no clear guidance for December

Decision to leave rates on hold in September was "close call"

The minutes of the Fed's September meeting highlighted that the FOMC is moving closer to raising interest rates, though divisions in the group were visible. The minutes noted that the "participants generally agreed that the case for increasing the target range for the federal funds rate had strengthened in recent months". Moreover, they noted that "several" FOMC members saw it as appropriate to raise the policy rate "relatively soon", and for many meeting participants the September meeting was a "close call". Indeed, three voting members of the committee dissented and voted to raise rates. The divisions were linked to the degree of remaining labour-market slack and how much more they could allow it to strengthen before raising rates. FOMC members also disagreed on whether the current inflation rate is sufficiently close to their 2% objective; many voting members remarked that "there were few signs of emerging inflationary pressures".

Fig. 5. US: Retail sales rebound in September, after weak July and August activity

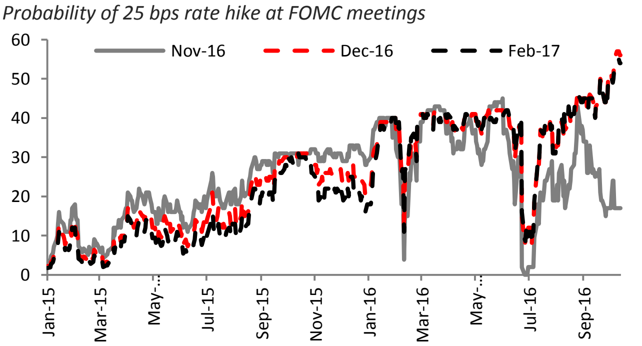
% change m-o-m



Source: US Census Bureau

Fig. 6. US: Markets continue to see December as most likely timing for 25 bps rate hike in 2016

Probability of 25 bps rate hike at FOMC meetings



Source: Bloomberg

Yellen's comments suggest very gradual rate hiking cycle going forward

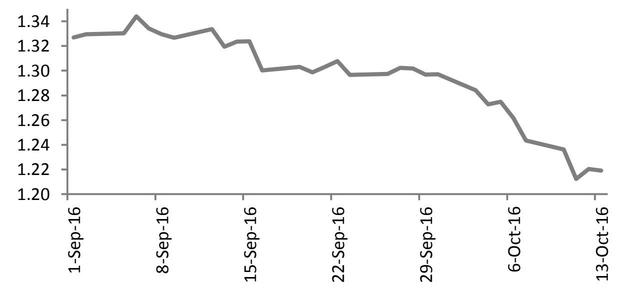
The minutes were very much in line with the post-meeting communication and we believe support our outlook for a December rate hike of 25 bps. They show that the Fed is more comfortable with hiking, though not quite there yet. Many participants are looking for greater evidence of inflationary pressure and moderation in labour market slack. Since the meeting, there have been some signs of a gradual pick-up in inflation, with core PCE strengthening to 1.7% y-o-y in August. Meanwhile, there was no clear guidance from Fed Chair Janet Yellen for the December meeting at her speech on 14 October to policy makers and academics. However, she highlighted that the Fed may have to run a "high-pressure economy" to reverse damage from the 2008-2009 crisis that depressed output and weakened the labour market. This would include policy to support aggregate demand and a tight labour market, even at the risk of higher inflation. Yellen's comments suggest a willingness to allow inflation to run beyond the Fed's 2% target. We continue to expect a very gradual rate hiking cycle in 2017, with our core scenario being a further 25 bps rate hike in December 2017.

Retail sales rebound in September – strong auto sales

September retail sales: were broadly in line with consensus expectations and showed a rebound from weak July and August activity. Headline retail sales increased by 0.6% m-o-m in September, in line with consensus forecasts. Autos sales were strong, alongside greater sales in the furniture, building material and restaurant sectors. The nature of spending resulted in "core" retail sales being weaker than market expectations (actual: 0.1%; consensus: 0.3%). Core sales exclude areas such as autos and gasoline, and feed into the GDP calculation. Overall, we see the softer 3Q retail sales as being largely a reaction to the strong 2Q gains.

Fig. 7. UK: GBP continued to depreciate over week as markets digested probability of "hard Brexit"

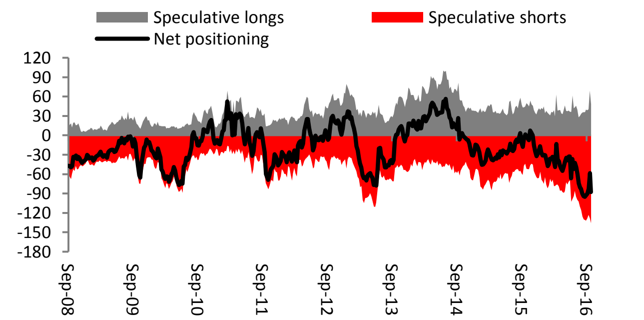
GBP:USD



Source: Bloomberg

Fig. 8. Sharp rise in speculative short GBP positions suggests that sell-off still has some way to go

'000s of contracts



Source: Commodity Futures Trading Commission, US

UK: GBP continues gradual decline over lingering Brexit uncertainties

Markets remain concerned over shape of post-Brexit EU-UK relationship

The GBP remained a barometer of the market's concerns around Brexit last week, sliding another 2%. The sell-off in the UK's fixed income and FX markets in October so far has been due to two major worries about the prospects for the UK's economy outside the EU. First, the UK government's determination to limit immigration from the EU might force EU officials to severely restrict UK firms' access to the EU single market (known as a "Hard Brexit"). Second, European governments have indicated a high price for the UK's departure from the EU, demanding the repayment of all past liabilities (close to EUR20 billion until 2019) that the country owes to the common EU budget. This could weigh on the UK's short-term fiscal outlook. However, believe that a weak GBP is positive for UK economy's outlook; export competitiveness picked up after the 1992 ERM crisis when the UK government devalued its currency. Nevertheless, the aforementioned uncertainties are unlikely to boost investment appetite among export-oriented firms until clarity over the post-Brexit EU-UK relationship emerges. We believe that a more conciliatory stance by the UK government over immigration from the EU will be key to ensuring a smooth Brexit.

C. Emerging Market Economies

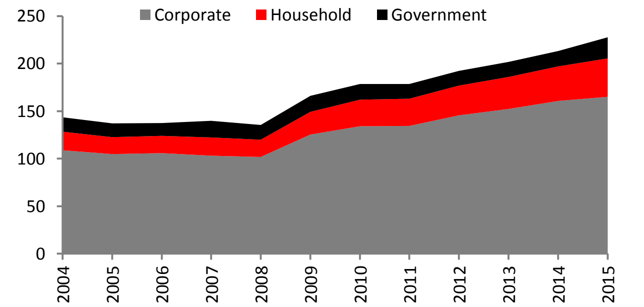
China: Government unveils debt-swap programme for corporates

Government invites private investors to swap close to RMB1 trillion in debt from stressed corporates

The Chinese State Council revealed the outlines of significant measures intended to address the rising corporate debt levels in the economy (currently 170% of GDP) last week, in another attempt to restore the country's debt sustainability. In our view, the programme will only be successful at reducing the pace of growth in corporate leverage rather than reducing its absolute level. Under the new measures, asset management companies and private investors will be invited to swap corporate debt of Chinese firms for equity in these firms. The proposed quantum of this debt swap programme, as per the state media reports, is close to RMB1 trillion (less than 1% of corporate debt).

Fig. 9. China: Corporate debt main driver of leverage since 2008

% of GDP



Source: Bloomberg

Fig. 10. China: Oil sector firms, included in initial debt swap proposals, see declining profit margins

Average profit margin of three largest listed firms

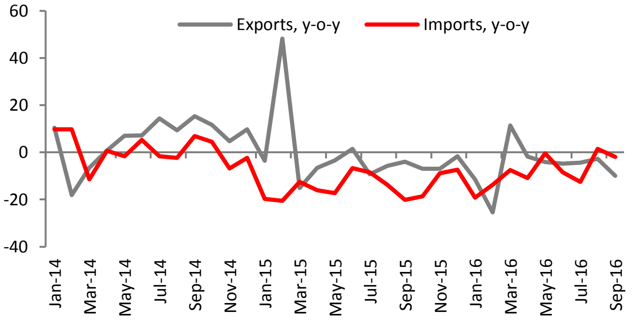
Source: Hang Seng, Shanghai Composite, Bloomberg

We believe current measures simply delay necessary but painful deleveraging

We remain sceptical of the ability of a debt-to-equity swap to resolve investment misallocation. First, we believe that most private investors are unlikely to participate in the programme given the tepid profit outlook for highly indebted firms in the manufacturing and energy sectors. Therefore, as per the past precedent in debt-restructuring programmes, most private investors are likely to be indirectly related to the Chinese state – raising questions about the pricing of debt and conflicts of interest. Second, although the government has expressed its commitment to bailing out "strategically new firms" through this programme, pilot plans presented to investors in 1H2016 showed that the state also plans to rescue firms in the petroleum and shipping sectors, which have seen a significant deterioration in growth prospects and fall in capacity utilisation. Overall, we believe that such state measures might provide some moderate support to growth prospects in 2017, but will do little to lower corporate debt to sustainable levels.

Fig. 11. China: Trade dynamics worsened in 3Q2016 and could be significant drag on growth

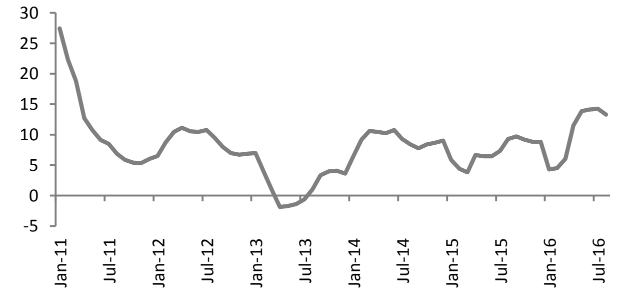
% change y-o-y



Source: National Bureau of Statistics

Fig. 12. China: Crude oil imports decelerated in 3Q due to factory shutdowns, we expect pick-up in 4Q

% change YTD y-o-y



Source: National Bureau of Statistics

China: Trade data reveals limit to export boost from weaker CNY

Export deceleration should continue in 4Q2016, imports likely to recover

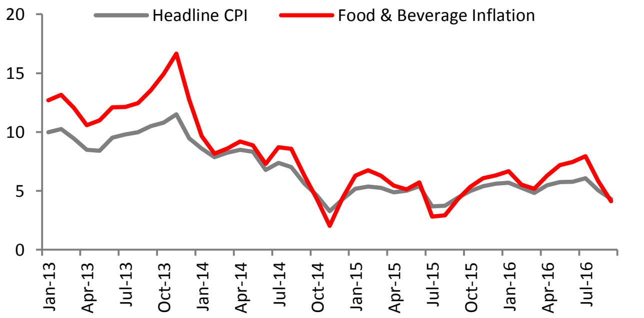
Meanwhile, Chinese trade data for September disappointed market expectations. Exports fell -10% y-o-y (consensus: -3.3%; August: -2.8%). The decline is further evidence for our view that CNY depreciation since August 2015 has done little to boost China's exports with external demand from major developed economies remaining sluggish. Exports to the G3 countries (US, Eurozone and Japan) fell for the third straight month in September. Nevertheless, despite this limited support to exports from CNY, we expect the PBoC to allow the local currency to gradually depreciate against the USD, as an indirect form of monetary easing. On the other hand, imports also fell by -1.9% y-o-y (consensus: 0.6%; August: 1.6), with significant deceleration in the imports of copper, crude oil and iron ore. We believe some of this slowdown might have been related to the one-off factory shutdowns in September, and that crude oil imports are likely to pick up in 4Q2016. However, with restrictions on property markets in major cities, imports of metals and cement might decline.

India: Inflation slows as food prices ease

Despite sharp slowdown in inflation, we do not expect RBI to cut rates in December

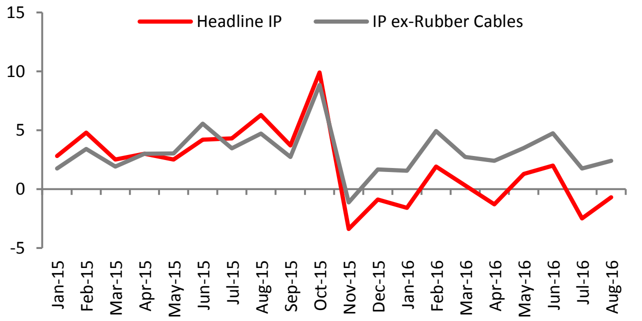
Inflation eased significantly in September to 4.3% y-o-y (August: 5.1%; consensus: 4.6%) undershooting market expectations. Almost all the decline was driven by a slowdown in food prices, which rose by a mere 4.1% y-o-y (August: 5.9%). Specifically, prices of vegetables and pulses, which had shot up in 2Q due to supply disruptions and dry weather, corrected sharply, and are likely to ease further through 4Q2016 in our view. However, despite this slowdown in inflation, we do not expect the RBI to cut its benchmark repo rate in its December meeting for two reasons. First, core inflation (primarily services), remains sticky (4.5% y-o-y in September; 4.3% in August) despite a deceleration in food prices. In our view, given the informal nature of India's economy and the large weight of food in the average worker's consumption basket, core inflation is a better measure of future inflation expectations (including expectations for food prices). Unless we see a gradual convergence between core and food prices, the case for a rate cut remains limited in our view. Second, we see upside risks to inflation, from October onwards, from a pick-up in energy prices, which could keep the RBI cautious about easing further. As such we expect no rate cuts by the central bank at least until March 2017. However, if March inflation undershoots its 5% target, we see a possibility of another 25 bps rate cut by the RBI in its April meeting.

Fig. 13. India: Much of decline in headline inflation can be attributed to correction in food prices in 3Q2016



Source: Central Statistical Office

Fig. 14. India: Adjusting for distorting impact of rubber cables, India's IP remained mildly positive in August



Source: Central Statistical Office

Headline GDP numbers do not fully reveal positive trends in consumer goods sector

Meanwhile, IP numbers for August showed a very small decline of -0.7% y-o-y (consensus: -0.8%; July: -2.5%) after the sharp plunge the previous month. However, we believe that markets are excessively concerned about the 3Q IP data being indicative of another quarter of capex contraction in 3Q GDP. In our view, much of the decline in the IP numbers this year has been due to sampling defects in a particular segment (rubber cables), which have distorted the real trend in industrial activity (see Fig 14). Diving into the details, we find that output of consumer goods, particularly cell phones and electrical appliances, continues to benefit from robustly growing household demand. Further, IP numbers since June also show a fragile recovery in output from infrastructure-related sectors (steel, commercial vehicles), suggesting a gradual impetus from public investment spending. Given these trends over the past few months, we expect small but positive capex growth (2-3% y-o-y) in 3Q GDP. A more sustainable recovery in capex growth to its pre-recession trend of 7%-8% is likely from 1HFY19 onwards.

II. Economic Calendar

Fig. 15. Upcoming events and data releases

Time	Country	Event	Period	Prior	Consensus
Expected this week					
	Saudi Arabia	CPI, y-o-y	Sep	3.3%	--
	UAE	Dubai's September Real Estate Sales, YTD y-o-y			
	UAE	Central Bank Foreign Assets	Sep	299.3B	--
	Qatar	GDP Constant Prices, y-o-y	2Q	1.1%	--
	Qatar	CPI, y-o-y	Sep	2.9%	--
	Bahrain	CPI, y-o-y	Sep	2.6%	--
	China	New Yuan Loans CNY	Sep	948.7B	1000B
	China	Aggregate Financing CNY	Sep	1469.7B	1390B
	China	Money Supply M2, y-o-y	Sep	11.4%	11.6%
	Oman	CPI, y-o-y	Sep	1.3%	--
	Oman	Nominal GDP YTD, y-o-y	2Q	-12.2%	--
Monday, 17 Oct					
3:01	UK	Rightmove House Prices, m-o-m	Oct	0.7%	--
16:30	US	Empire Manufacturing	Oct	-2	1
17:15	US	Industrial Production, m-o-m	Sep	-0.4%	0.2%
Tuesday, 18 Oct					
	India	RBI releases minutes of Oct MPC meeting			
12:00	Eurozone	ECB Bank Lending Survey			
12:30	UK	CPI, y-o-y	Sep	0.6%	0.9%
16:30	US	CPI, y-o-y	Sep	1.1%	1.5%
16:30	US	CPI ex-Food and Energy, y-o-y	Sep	2.3%	2.3%
Wednesday, 19 Oct					
0:00	US	Total Net TIC Flows	Aug	$140.6B	--
6:00	China	Industrial Production, y-o-y	Sep	6.3%	6.4%
6:00	China	Retail Sales, y-o-y	Sep	10.6%	10.7%
6:00	China	Fixed Assets, ex-Rural, YTD y-o-y	Sep	8.1%	8.2%
6:00	China	GDP, y-o-y	3Q	6.7%	6.7%
8:30	Japan	All Industry Activity Index, m-o-m	Aug	0.3%	0.3%
12:30	UK	Claimant Count Rate	Sep	2.2%	2.2%
12:30	UK	Jobless Claims Change	Sep	2.4K	3.2K
12:30	UK	ILO Unemployment Rate	Aug	4.9%	4.9%
15:00	US	MBA Mortgage Applications	14-Oct	-6%	--
16:30	US	Housing Starts	Sep	1142K	1175K
16:30	US	Building Permits	Sep	1152K	1165K
16:45	US	Fed's Williams Speaks in New Jersey			
22:00	US	US Federal Reserve Releases Beige Book			
Thursday, 20 Oct					
12:30	UK	Retail Sales ex-Auto Fuel, m-o-m	Sep	-0.3%	0.2%
12:30	UK	Retail Sales ex-Auto Fuel, y-o-y	Sep	5.9%	4.4%
15:00	Turkey	CBRT Benchmark Policy Rate	20-Oct	7.5%	7.5%
15:00	Turkey	CBRT Overnight Lending Rate	20-Oct	8.25%	8%
15:45	Eurozone	ECB Main Refinancing Rate	20-Oct	0%	0%
15:45	Eurozone	ECB Deposit Facility Rate	20-Oct	-0.4%	-0.4%
15:45	Eurozone	ECB Asset Purchase Target	Oct	EU80B	EU80B
16:30	US	Initial Jobless Claims	15-Oct	246K	250K
16:30	US	Philadelphia Fed Business Outlook	Oct	12.8	6
18:00	US	Existing Home Sales	Sep	5.33M	5.35M
Friday, 21 Oct					
	US	Fed's Williams speaks in San Francisco			

* UAE time
Source: Bloomberg

Fig. 16. Last week's data

Date Time	Country	Event	Period	Prior	Consensus	Actual
MENA/India data						
	UAE	CPI, y-o-y	Aug	1.8%	--	0.6%
	UAE	September Dubai, Abu Dhabi Home Prices by Cluttons				
	India	Exports, y-o-y	Sep	-0.3%	--	4.6%
	Oman	CPI, y-o-y	Sep	1.3%	--	
	Oman	Nominal GDP, YTD y-o-y	2Q	-12.2%	--	
Monday, 10 Oct						
	Egypt	Urban CPI, y-o-y	Sep	15.5%	--	14.1%
	Egypt	CPI Core, y-o-y	Sep	13.3%	--	13.9%
16:00	India	Industrial Production, y-o-y	Aug	-2.5%	-0.8%	-0.7%
Tuesday, 11 Oct						
3:50	Japan	BoP Current Account Balance	Aug	¥1938.2B	¥1502.7B	¥2000.8B
3:50	Japan	Trade Balance BoP Basis	Aug	¥613.9B	¥116.5B	¥243.2B
8:15	UAE	Dubai Economy Tracker SA	Sep	55.7	--	55.1
13:00	Eurozone	ZEW Survey Expectations	Oct	5.4	--	12.3
Wednesday, 12 Oct						
3:50	Japan	Machine Orders, m-o-m	Aug	4.9%	-4.7%	-2.2%
13:00	Eurozone	Industrial Production SA, m-o-m	Aug	-0.7%	1.5%	1.6%
15:00	US	MBA Mortgage Applications	7-Oct	2.9%	--	-6%
18:00	US	JOLTS Job Openings	Aug	5831	5800	5443
Thursday, 13 Oct						
	China	Trade Balance	Sep	$52.05B	$53B	$42B
	China	Exports, y-o-y	Sep	-2.8%	-3.3%	-10%
	China	Imports, y-o-y	Sep	1.5%	0.7%	-1.9%
8:30	Japan	Tertiary Industry Index, m-o-m	Aug	0.2%	-0.2%	0%
16:00	India	CPI, y-o-y	Sep	5.1%	4.6%	4.3%
16:30	US	Initial Jobless Claims	8-Oct	246K	253K	246K
Friday, 14 Oct						
3:50	Japan	Money Stock M3, y-o-y	Sep	2.8%	2.9%	3.1%
3:50	Japan	PPI, y-o-y	Sep	-3.6%	-3.2%	-3.2%
5:30	China	CPI, y-o-y	Sep	1.3%	1.6%	1.9%
16:30	US	Retail Sales Advance, m-o-m	Sep	-0.2%	0.6%	0.6%
16:30	US	Retail Sales, ex-Auto, m-o-m	Sep	-0.2%	0.5%	0.5%
18:00	US	U. of Mich. Sentiment	Oct P	91.2	91.8	87.9

* UAE time
Source: Bloomberg

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